

CORPORATE STATEMENT



The British Columbia Railway Group comprises three companies:

- British Columbia Railway Company, which holds investments in its two subsidiary companies
- BCR Properties Ltd., which owns and manages the group's non-operating real estate assets and
- BC Rail Ltd., which is the group's railway operating company.

The Province of British Columbia is the sole shareholder of British Columbia Railway Company, which holds 100 per cent of the common shares of BCR Properties Ltd. BCR Properties owns 75 per cent of the

common shares of BC Rail Ltd., the remaining 25 per cent of which is held by British Columbia Railway Company.

In June, 1984, BC Rail offered eight million Series 'A' First Preferred Shares, at a unit price of \$25.00, for sale on Canadian stock exchanges. The non-voting stock offer was fully-subscribed and the \$200 million raised was used in part to acquire the railway assets from British Columbia Railway Company which in turn, retired short-term borrowings.

The operating railway company, BC Rail Ltd., operates in a competitive environment and is principally engaged in the carriage of natural resources from British Columbia to world markets. Major sources of revenue are derived from the transportation of forest products and coal, the remainder from ore concentrates,

petrochemicals, sulphur, grain and general freight. The railway also operates an intermodal division and a passenger service between North Vancouver and Prince George.

BC Rail operates and maintains 1,390 miles of main track between North Vancouver and its northern terminal in Fort Nelson, B.C. While it operates exclusively in British Columbia, BC Rail has online connections to all rail-served points in North America and most of the traffic carried is destined for delivery outside the province.

The railway is provincially regulated. It owns or leases 122 locomotives, more than 10,000 freight cars and nine self-propelled passenger cars. Assets exceed \$1.2 billion and in 1984, total revenues were in excess of \$250 million.

British Columbia Cataloguing in Publication Data

British Columbia Railway
Annual Report-1972-Annual
Continuous: Pacific Great Eastern Railway.
Annual Report. ISSN 0702-942X
ISSN 0702-9438 = Annual Report-British
Columbia Railway.
1. British Columbia Railway.

ME2B10.B7B75

354.711'0037'5068

A 3,000 hp diesel-electric unit heads a northbound freight near Squamish, B.C. The familiar two-tone green will soon be gone forever as the motive power and caboose fleet is progressively repainted in red, white and blue.

Nearly 500 supervisory, technical and clerical staff are employed in the company's North Vancouver headquarters.

Approximately 1,700 of BC Rail's 2,600 employees are represented by seven member unions of a council of trade unions.

The railway's repair and maintenance facilities in north central and southern British Columbia handle major overhauls and rebuilds as well as routine road maintenance.

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FINANCIAL HIGHLIGHTS

	(Dollars in Thousands)	
	1984	1983
Operating revenues	\$256,108	\$205,446
Operating expenses	\$189,199	\$165,494
Operating income	\$66,909	\$39,952
Net income before minority interest	\$42,687	\$39,967
Net income	\$34,342	\$39,967
Carloadings	200,257	148,769
Tons hauled	14,672,412	9,347,107
Number of employees at year-end	2,640	2,600

BOARD OF DIRECTORS

J. Norman Hyland, *Chairman*
S. C. Cooper
Stanley M. Horner
E. Cecil Hurd
John C. Kerr

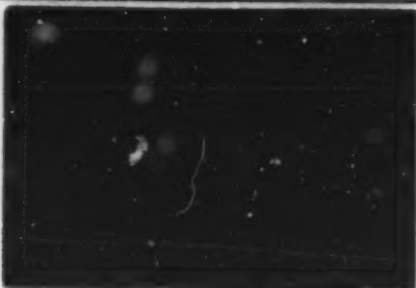
E. A. Moffat
M. C. Norris
Hon. Don M. Phillips
Bruce Rome

(Mr. Glenn W. McPherson and Mr. Robert E. Swanson resigned from the Board on November 28th, 1984. Messrs. Cooper and Moffat were appointed on November 30th, 1984).

OFFICERS

M. C. Norris *President and Chief Executive Officer*
J. R. Clarke *Vice-President - Finance*
Brian Foley *Vice-President - Industrial Relations*
N. A. McPherson *Vice-President - Operations and Maintenance*
G. L. Ritchie *Vice-President - Administration and Secretary*
A. C. Sturgeon *Vice-President - Marketing and Sales*

DIRECTORS' REPORT



The operations and the financial structure of the British Columbia Railway Company underwent substantial change during 1984. Carloadings and freight tonnage reached new record levels, principally as a result of the first full year of operation in moving coal from the two new mines at Tumbler Ridge. Freight volume from the forest products industry was adversely affected by the 10-week closure of the pulp mills served by our rail system. The impact of this record freight volume is more fully reported by the President and in the company's audited financial statements.

The Directors' Report for 1983 advised that the provincial government had agreed to eliminate the historic debt of the railway by making a payment to the sinking funds which would be sufficient to meet all interest payments and principal maturities. (The 'historic debt' had been defined as the capital cost of extensions to the mainline system which had been completed many years ago and which had been funded by the railway, less the sinking fund payments which had been made in past years). This agreement was implemented by the government's

payment of \$430 million on June 15th, 1984.

The 1983 report also advised that the government and the railway were jointly considering the most cost effective way to finance the Tumbler Ridge extension. These discussions culminated in a reorganization of the company which enabled it to finance a portion of the Tumbler Ridge extension by the issue of preferred shares. The sum of \$200 million was raised by the sale of eight million shares of \$25 par value.

The balance of the \$500 million cost of the Tumbler Ridge extension was provided by an equity subscription of \$61 million from the provincial government; \$86 million from the railway's own resources and approximately \$153 million in short term borrowings.

The net result of these financial transactions is that the company now has a sound balance sheet with a satisfactory debt to equity ratio and equally important, its rail operations will provide the cash flow required to service the remaining debt and to meet the dividend requirements on the preferred share issue. All of the above represent a significant achievement for the company.

No major capital projects are planned for 1985 but the system will require annual expenditures to maintain the line and equipment to the required operating standard and to upgrade those sections which do not meet that standard.

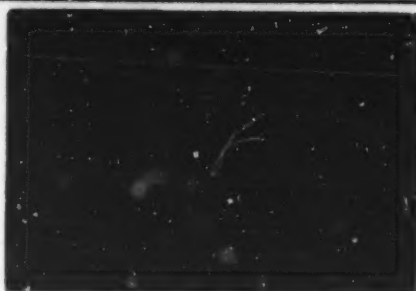
In November, Mr. Glenn W. McPherson and Mr. Robert E. Swanson resigned from the Board and were succeeded by Mr. S. C. Cooper and Mr. E. A. Moffat. Mr. Swanson joined the Board in 1972, while Mr. McPherson was appointed in 1976. I would like to take this opportunity of thanking Messrs. McPherson and Swanson for their loyal years of service, during which they both gave unstintingly of their time and knowledge for the good of the railway.

Earlier in the year, I had the pleasure of welcoming Mr. John C. Kerr to the Board. Mr. Kerr succeeded the late Mr. Jack N. Fraine, who died in the fall of 1983.

The company employs approximately 2,600 people, comprising managers, supervisors, running trades, engineering and maintenance personnel, clerical staff and many others. To all of these, the Board extends its thanks for a successful operating year and for their important contribution to the operating results.

J. N. Hyland, Chairman

PRESIDENT'S REPORT



Nineteen-eighty-four was an exceptional year of accomplishment for the British Columbia Railway group of companies. It was marked by a third successive year of record net income before dividend payments to preferred shareholders; record carloadings; corporate and financial reorganization which led to retirement of the company's historic, long-term debt; the formation of two subsidiary companies and the company's first-ever issue of preferred shares on public stock exchanges.

Other milestone events during the year included:

- application to the Canadian Radio-Television and Communications Commission (CRTC) for approval to interconnect to British Columbia Telephone Company (BC Tel)
- union and management agreement to refer the issue of reduced train crew size to binding arbitration
- recognition of BC Rail by the federal Ministry of Transport in Bill C-155, the Western Grain Transportation Act.

Record net income before minority interest of \$42.7 million and carloadings which passed the 200,000 level for the first time in the company's 72-year history were achieved despite a prolonged

closure of British Columbia's pulp and paper industry at the beginning of the year. The resulting decline in general freight carloadings was more than offset by the addition of 57,486 coal carloads, which emphasizes the importance of coal to the railway in maintaining an economic level of operations. The satisfying results also reflect management's continuing commitment to cost controls.

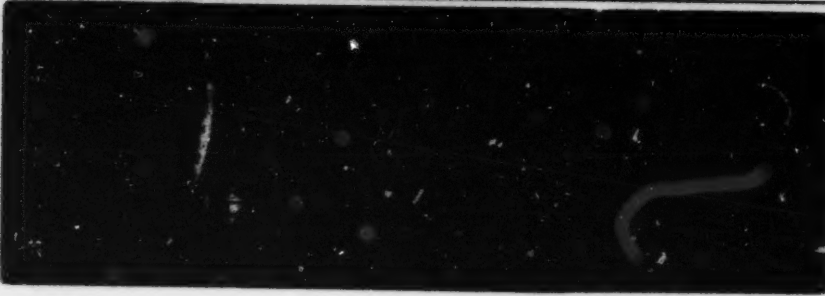
Consolidated financial statements for 1984 reflect the restructuring of the group's capital base. A payment of approximately \$430 million by the provincial government was added to the company's sinking funds and will provide sufficient monies for all future interest and principal payments on historic debt. This permitted removal of the debt from the financial statements.

As part of the financial restructuring, BC Rail assumed responsibility for approximately \$366 million of short-term debt incurred in construction of the Tumbler Ridge line. The financing required for the line was reduced considerably by the direct application of \$86 million from the company's cash flow. Upon assumption of the Tumbler Ridge construction debt by the company, coal surcharge payments which originally were to have been paid to government, instead were assigned to the railway. The coal transportation surcharges are intended to offset construction costs of the new line.

Financial reorganization resulted in the formation of two new subsidiary companies, BC Rail Ltd. and BCR Properties Ltd., and the issue — through BC Rail Ltd. — of \$200 million of Series 'A' First Preferred Shares on public markets. BC Rail thus became the group's railway operating company while BCR Properties acquired and became responsible for the management and development of the group's considerable real estate holdings. The proceeds from the preferred share issue were used in part to acquire the operating assets from British Columbia Railway Company.

In view of the fact that debt servicing charges and preferred share dividend obligations after the financial reorganization were met entirely from the group's own operating resources and revenues, the 1984 financial results are especially gratifying.

BC Rail's application to the CRTC followed a decision to organize its Communications department as a profit centre in order to expand and market microwave communications facilities to public users. The company's submissions were heard in Ottawa in late fall and a ruling, which management anticipates will be favourable, is expected in mid-1985. On that assumption, planning continues in this area and the company looks forward to competing with existing suppliers of these services.



The issue of train crew size has been a disruptive factor in the railway's industrial relations for over 10 years. The railway's practice of operating with a crew of four, consisting of an engineman, a conductor and two trainmen is antiquated, since most North American railways have abolished the second trainman's position and operate with a crew of three.

The company's revenues depend largely upon the export of lumber, sulphur, ore concentrates, coal, pulp, paper and grain. Many of our competitors have distinct advantages in climate, terrain, labour costs, length of haul to tidewater and distance to markets, all of which have a significant effect upon transportation costs.

Train crew reduction is a critical objective to ensure that the company remains competitive by providing the most efficient transportation service possible. We are pleased that this issue is now to be resolved by final and binding arbitration. Its resolution is essential for the long-term job security of all employees.

Negotiations with respect to grain transportation are continuing with the new federal Minister of Transport and it is anticipated they will conclude early in 1985. Compared with the two national carriers, BC Rail's grain transportation volume is small. However, the recognition of BC Rail in the Western Grain Transportation Act — which provides for the carriage of grain at economic rates — stirs management optimism that there is potential for development of increased traffic in the Peace River region of the province, which BC Rail serves.



For the owners, employees and new shareholders of BC Rail, there can be little doubt that 1984 was a signal year in the organizational, financial and operational development of the company. I am grateful to our employees for their continuing commitment to excellence and for their efforts over this and earlier years in bringing the railway to its present state of profitability and efficiency. I am grateful also, for the confidence of the Canadian investment community in responding so quickly and enthusiastically to BC Rail's first public share offering.

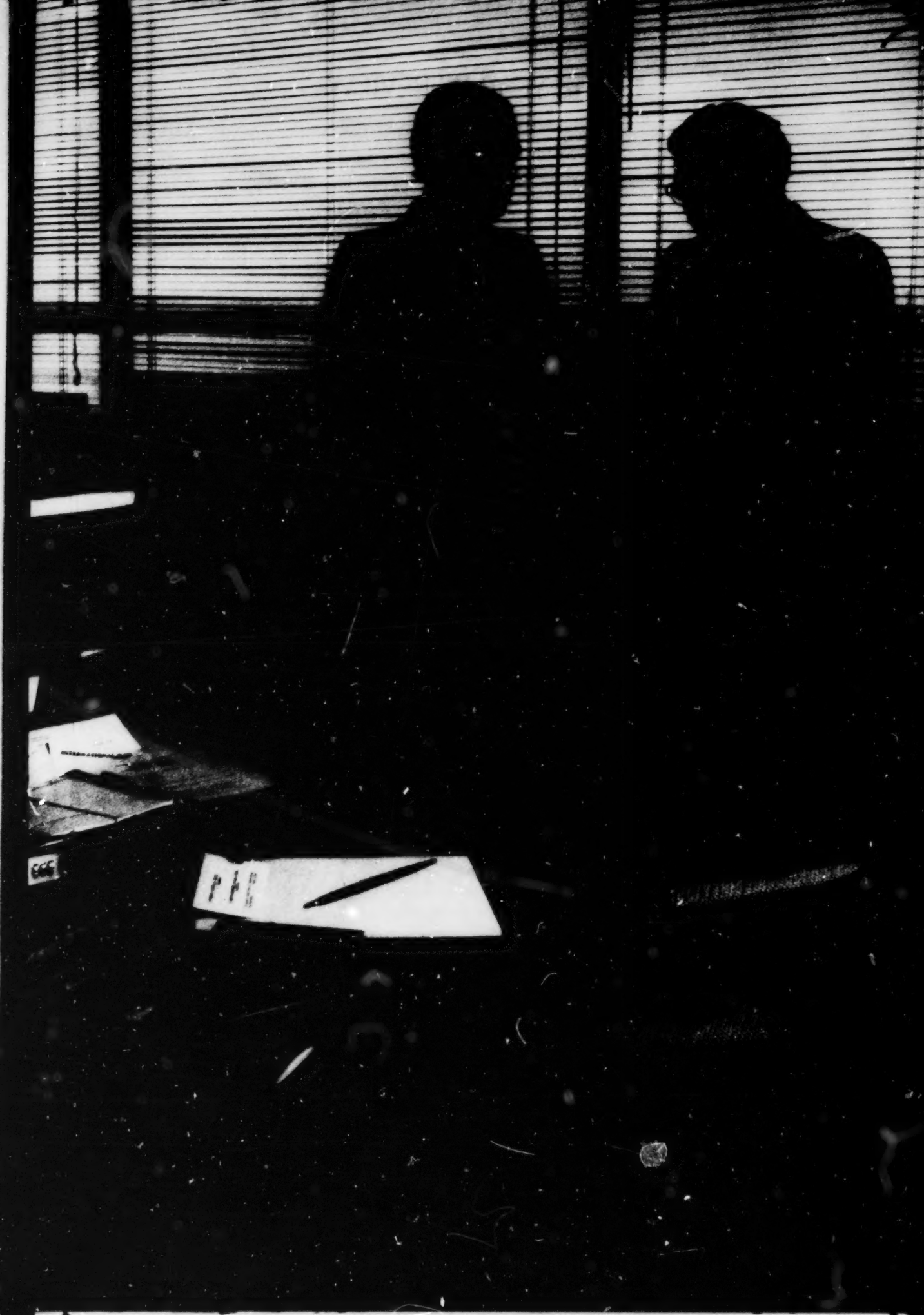


M.C. Norris, President
and Chief Executive Officer

BC Rail's Communications profit centre awaits a decision from the Canadian Radio-Television and Telecommunications Commission to permit broader marketing of microwave, voice and data transmission facilities. The railway was among the first in North America to be microwave-equipped and for a number of years, it has leased microwave transmission services to institutional users.

BC Rail employs the most advanced data processing technology available and a number of major systems and programs have been designed and developed internally.

International Rail Consultants, a joint venture in cooperation with Vancouver's Swan Wooster Engineering Ltd. was formed early in 1985 to market railway management and engineering consulting services worldwide. Soon after agreements were signed, the new joint venture won a contract to advise Kenya's national railway on maintenance of Montreal-built locomotives and stores and inventory management.



THE YEAR IN REVIEW



Nineteen-eighty-four was a remarkable year for the British Columbia Railway group of companies.

It began inauspiciously with a 10-week closure of British Columbia's pulp and paper industry, which seriously affected the railway's first quarter carloadings and revenues. It ended, however, as the third consecutive year of record net income and a year in which carloadings reached their highest levels ever. Net income before minority interest reached \$42.7 million, compared with \$40 million recorded for the 1983 fiscal year.

In mid-1984, the provincially owned British Columbia Railway Company was reorganized to become a holding company for two new subsidiaries, BC Rail Ltd. — the group's railway operating company — and BCR Properties Ltd., which acquired and now manages the non-operating real estate assets of the group of companies.

As a consequence of the reorganization, it became possible for BC Rail Ltd. to issue \$200 million in guaranteed, redeemable, retractable preferred shares on Canadian stock markets — an offering that was fully subscribed soon after it was announced in May. The reorganization and preferred share offering, their effect upon the railway and the relationships between the three

companies and the provincial government, are explained elsewhere in this report.

Despite little positive indication of economic recovery in the province, as well as the prolonged pulp and paper dispute, BC Rail 1984 carloadings passed the 200,000 level for the first time in the company's 72-year history. This represents an increase of more than 29 per cent over the company's previous best year in 1978, when loadings totalled 154,850.

The substantial increase in carloadings is largely attributable to the fact that 1984 was the first full year in which the railway transported thermal and metallurgical coal from northeastern British Columbia to the CN Rail interchange in Prince George. A total of 57,486 cars, containing 5.8 million short tons of coal, was hauled over the railway's new electrified line between Tumbler Ridge and the mainline at Tacheeda, B.C. The decline of approximately four per cent in general freight carloadings was attributable to the pulp and paper dispute.

United States lumber manufacturers' efforts to restrict Canadian lumber imports gave rise to concern during the year. Following an unsuccessful application to the International Trade Commission in 1983, U.S. producers lobbied in 1984 for

Canadian imports to be restricted by quota and for the imposition of countervailing duties. The Gibbons Bill, as the proposed legislation was called, failed to receive Senate assent and did not therefore pass into law.

Nevertheless, vigorous attempts to restrict Canadian producers' market share persist and BC Rail shares the forest industry's concern about the impact on the provincial economy should they be successful.

Like other Canadian railways, BC Rail has been subjected to the pressure of increased competition from both the road transport industry and deregulated U.S.-based railways. In mid-year, BC Rail intervened in Canadian Transport Commission deregulation hearings in support of submissions by CN and CP Rail.

BC Rail's freight rates are provincially regulated while those of the two transcontinental carriers are regulated by Canadian federal statute. Following passage of the U.S. Staggers Act of 1980, U.S. railways have had the freedom to negotiate confidential freight rates with individual shippers, both in Canada and the United States. This puts Canadian carriers at a severe disadvantage and emphasizes the early need for change if they are to compete effectively with their U.S. counterparts and maintain an equitable share of market.

The company and its seven member council of trade unions

Early in 1985, BC Rail began changing the livery of its fleet of locomotives and cabooses from green to red, white and blue. The green paint scheme was introduced when the railway changed its name to British Columbia Railway in 1972. The latest livery change follows the formation of BC Rail Ltd., the group's operating subsidiary company.



began negotiating a new contract in the spring of 1984, following expiry of the former contract in February. The principal outstanding issue at year-end was the matter of reduced train crews. The railway served lockout notice on November 30th but with the intervention of senior representatives of the B.C. Ministry of Labour, both parties voluntarily agreed to refer the reduced crew issue to binding arbitration. Hearings began early in 1985 and a ruling is expected in May. Negotiations for an overall collective agreement have continued into 1985.

In October, BC Rail appeared before the Canadian Radio-Television and Telecommunications Commission to seek authorization to expand the scope of its existing interconnection facilities with the British Columbia Telephone Company. BC Rail argued that it should be allowed to provide private voice and data transmission service in competition with the telephone company, interconnected to the utility's local distribution lines. The railway believes such competition will benefit the provincial economy and expects a decision in mid-1985.

BC Rail's microwave communication system was the first to be constructed by a common carrier in British Columbia and the railway has a long history of involvement with private users, including the telephone company



and CNCP Telecommunications.

As year-end approached, the company completed plans to launch a joint venture with Swan Wooster Engineering Ltd., to be known as International Rail Consultants. The new joint venture's objective is to market railway engineering expertise and technology to developing nations and elsewhere. International rail consultants became operational early in 1985.

The company intends to aggressively develop and market its landholdings, which now include 48,000 acres (19,425 hectares) of property.

During the year, the last of seven 6,000 hp electric locomotives was delivered by General Motors Diesel Division. The units are deployed on the 50 kilovolt, electrified Tumbler Subdivision. In October, the railway announced an order for five new, 3,000 hp SD40-2 diesel-electric locomotives from the same supplier. The new locomotives are to replace units retired during the year and they are scheduled for delivery in June, 1985. Like their electric counterparts, they will wear the railway's new, red, white and blue livery, following a decision to progressively repaint the entire fleet of locomotives and cabooses as repainting falls due. The new locomotives will bring motive power fleet strength to a total of 127 freight units and nine Budd passenger cars.

To accommodate the railway's growing requirements for a major maintenance and repair facility in north central British Columbia, work began in June on construction of a new diesel shop in Prince George — the hub of BC Rail's northern operations. Construction cost of the new shop was estimated at \$7.8 million and completion is expected in the summer of 1985. The railway's existing diesel shop was built in 1965 and is too small for the railway's needs.

Over the past decade, more than \$15 million has been invested in new facilities in Prince George to improve the operational efficiency of this important northern centre.

Work continued during the year on upgrading the railway's mainline between Tacheeda, B.C., and Prince George. The four-year program was announced in 1983 and included rail relaying, tie and ballast replacement, culverting and bank-widening and the installation of a diamond crossing at Prince George. The work was necessary to accommodate the 13,000-ton unit coal trains operating between Tumbler Ridge and Prince George. Coal trains are switched to CN Rail at that point, for onward carriage to Prince Rupert, from where the coal is destined for Japan. The upgrading project is expected to cost \$64 million.

A persistent water seepage problem in the railway's two long tunnels on the Tumbler subdivision was addressed during the year.

Early morning activity at the railway's locomotive rebuild centre. BC Rail has major repair and maintenance facilities in both Prince George and Squamish, B.C. A new diesel shop will be completed in Prince George in mid-1985.

A pair of General Motors GF6-C, 6,000 hp electric locomotives heading a unit coal train on the Tumbler subdivision. Coal trains are electrically-powered to the mainline at Tacheeda, B.C.

The Japanese freighter Shoryu Maru berthing at the new Ridley Island deep-sea coal terminal, prior to loading the first shipment of northeast coal in January, 1984. Ridley Island is near Prince Rupert, in northwestern British Columbia.

REVIEW

Because of extreme winter temperatures in the region, water flow from tunnel roofs and walls had been freezing and interfering with the coal train operating cycle. Employing insulation technology used only once before, BC Rail crews completed the project in record time and as a result, the running water is sheltered from the freezing winds that characterize the climatic conditions of the area. The insulation process prevents the water from freezing at the rock face and allows it to run freely from the tunnels.

Nineteen-eighty-four saw improvements to the railway's data processing equipment with the addition of a second Digital VAX 11/780 computer. The new machine enhances the company's teleprocessing facility and allows for future expansion. Early in January, 1985, the company also upgraded its IBM mainframe computer to accommodate a new financial reporting system and to provide twice the power of the existing machine. The upgraded computer uses the fourth generation computer language 'Focus.'

A computerized car repair and billing system, developed by the company, became operational during the year. As well as

providing an excellent method of work standard monitoring and record-keeping, the Car Repair Information Billing System (CRIBS) is invaluable in tracking repair work carried out on BC Rail rolling stock by offline carriers and billing other carriers for repairs to equipment performed by BC Rail.

CRIBS guards against inaccurate billings by other railways and ensures that offline repair work meets BC Rail standards. The system also provides maintenance profiles on rolling stock so that preventive maintenance may be undertaken in the railway's own shops at lower cost than would be the case were the work carried out offline.

Work continued during the year on refurbishing the railway's nine-car passenger fleet, which operates between North Vancouver and Prince George. The railway intensified its efforts to improve ridership and in cooperation with regional tourism authorities and other organizations, the overall passenger product continued to improve. As a result of rail package holidays cooperatively developed by the railway and regional tourism development associations, passenger traffic to the Cariboo and Whistler areas improved during the fall and winter months.

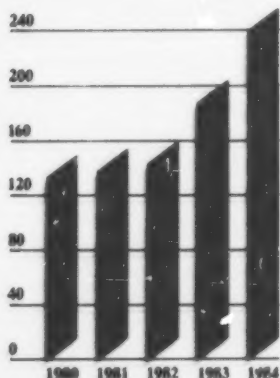
In October, the railway held a premiere showing of a new corporate film, '995 Days,' a 28-minute documentary film of the Tumbler subdivision electrification project. The film is being widely distributed as an educational and informational vehicle around the world and is proving particularly useful to other railways considering electrification as an alternative to fossil fuels.

Following the sudden death of P. A. (Archie) MacDonald, the company's Vice-President - Industrial Relations, Brian Foley was appointed Vice-President - Industrial Relations. Prior to joining the company in August, 1984, Mr. Foley was Vice-Chairman and Registrar of the B.C. Labour Relations Board.

Management is optimistic that the railway's success over the last several years will continue throughout 1985, recognizing that competition and economic pressures from an increasing variety of sources will persist and strengthen. The railway's efforts to control operating costs will remain in place. It is largely because of management's attention to such matters that financial strength has been maintained in a difficult business climate.

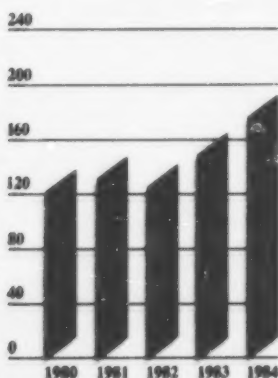
Consolidated Operating Revenues

280 \$ MILLIONS



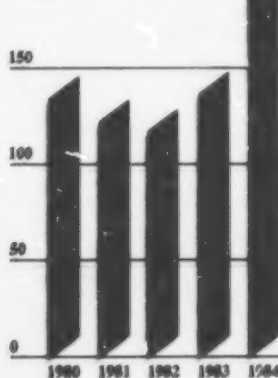
Consolidated Operating Expenses

280 \$ MILLIONS



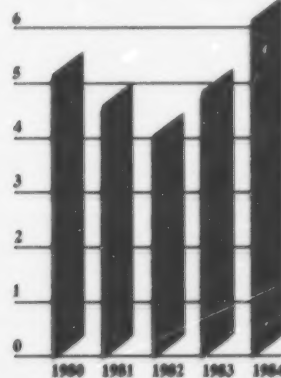
Consolidated Car Loadings

200 THOUSANDS



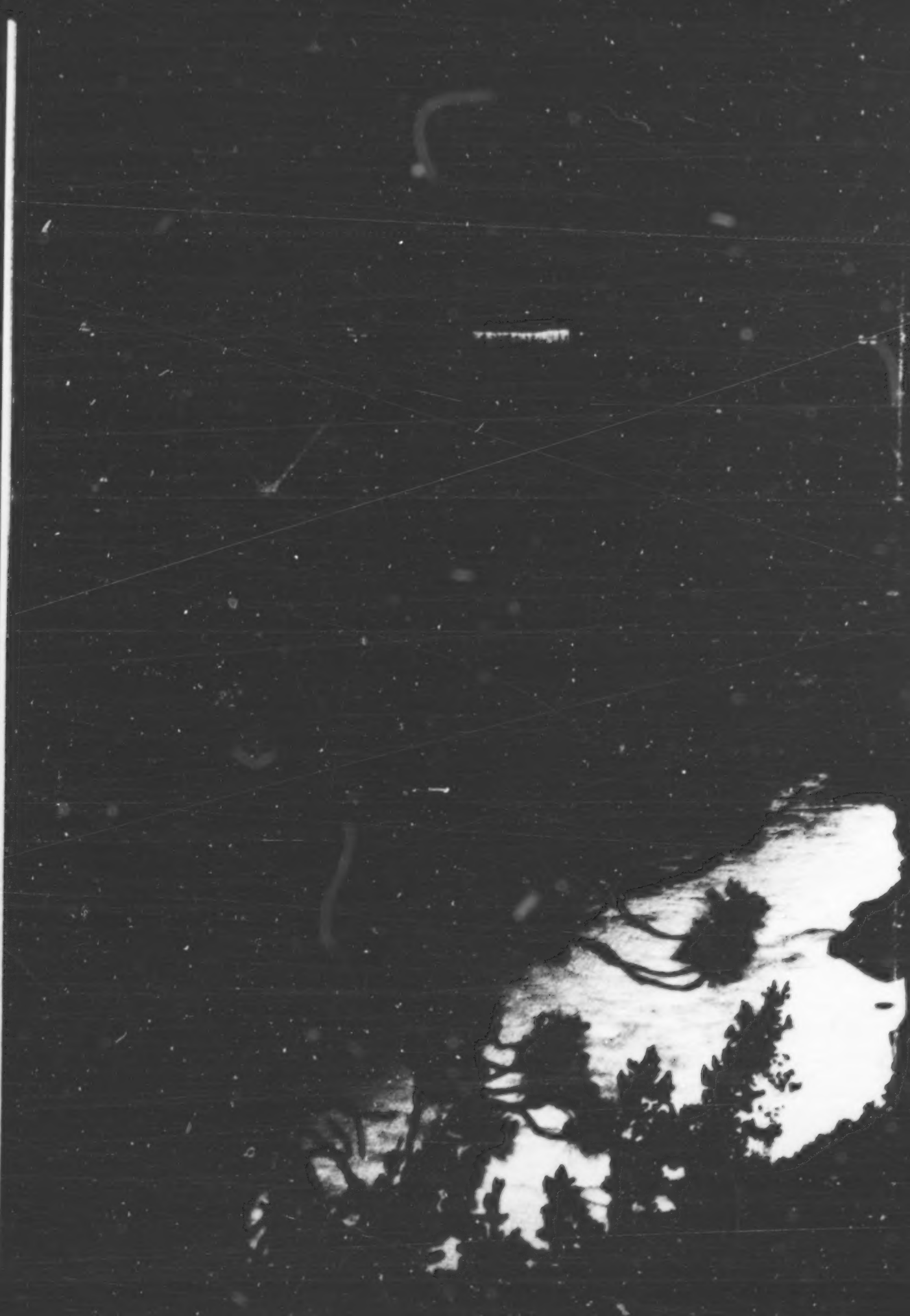
Consolidated Gross Ton Miles

7 BILLIONS



BC Rail designed and built a special train to erect the Tumbler subdivision's 50 kilovolt overhead conductor system needed to power electric locomotives.

The catenary is based on technology developed by SvedelRail, a subsidiary of Swedish State Railways, which also provided consulting personnel and services.



CONSOLIDATED FINANCIAL STATEMENTS FOR BRITISH COLUMBIA RAILWAY COMPANY

BC Rail's Intermodal Services profit centre is a growing source of revenue for the company. 'Figgback' service offers swift, reliable and economical all-weather transportation to and from destinations in northern B.C. while reducing tractor and trailer wear and heavy road haul expenses.

BRITISH COLUMBIA RAILWAY COMPANY MANAGEMENT REPORT

The consolidated financial statements of British Columbia Railway Company have been prepared by management in accordance with accounting principles generally accepted in Canada for railways in a manner consistent with the previous year. Management is responsible for the accuracy, integrity and objectivity of the information contained in the financial statements and to ensure that the presentation conforms with generally accepted accounting principles.

The independent auditors, Peat, Marwick, Mitchell & Co., have been appointed by the Lieutenant Governor in Council to express an opinion as to whether these consolidated financial statements present fairly the company's financial position and operating

results in conformity with generally accepted accounting principles consistently applied. Their report outlines the scope of their examination and gives their opinion on the fairness of the statement presentation.

The Audit Committee of the railway directors appointed by the Board meets periodically with financial officers of the railway and the external auditors to ensure that each group is fulfilling its obligations and to review and approve the annual financial statements prior to their release.

Management maintains an extensive system of internal accounting controls and believes that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial statements. The

adequacy and operation of the control systems are monitored on an on-going basis by an internal audit department.

The Canadian Institute of Chartered Accountants recommends that supplementary information on the effects of changing prices be presented together with the annual financial statements of large publicly-held enterprises. Management does not believe that the development of this information is practicable.

The consolidated financial statements have, in the opinion of the management of the company, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized in Note 1 of the Notes to the financial statements.

AUDITORS' REPORT

To the Lieutenant Governor
in Council
Province of British Columbia

We have examined the consolidated balance sheet of British Columbia Railway Company as at December 31, 1984 and the consolidated statements of income and deficit, contributed surplus and changes in financial position for the year then ended.

Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31,

1984 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Vancouver, British Columbia,
Canada
February 28, 1985

BRITISH COLUMBIA RAILWAY COMPANY

CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

Assets	December 31 1984	December 30 1983
Current assets		
Cash	\$ 9,649	\$ 22,583
Accounts receivable	39,604	30,733
Materials and other items	31,802	30,600
	<u>81,055</u>	<u>83,916</u>
Deferred income taxes	1,954	—
Property and equipment		
Road and buildings	1,036,583	979,787
Equipment	229,476	228,770
	<u>1,266,059</u>	<u>1,208,557</u>
Accumulated depreciation	195,668	176,205
	<u>1,070,391</u>	<u>1,032,352</u>
Dease Lake extension — Note 3	98,020	98,020
	<u><u>\$1,251,420</u></u>	<u><u>\$1,214,288</u></u>
 Liabilities and Shareholder's Equity		
Current liabilities		
Accounts payable	\$ 85,741	\$ 107,875
Current obligations on long-term debt	993	9,754
	<u>86,734</u>	<u>117,629</u>
Long-term debt — Note 4	196,282	975,625
Minority interest — Note 5	200,000	—
Shareholder's equity		
Share capital — Note 6	257,688	257,688
Contributed surplus	510,716	137,485
	<u>768,404</u>	<u>395,173</u>
Deficit	—	274,139
	<u>768,404</u>	<u>121,034</u>
Commitments — Note 7		
Contingent liabilities — Note 8		
	<u><u>\$1,251,420</u></u>	<u><u>\$1,214,288</u></u>

On behalf of the Board

S. M. Horner *M. C. Norris*

S. M. Horner, Director

M. C. Norris, Director

BRITISH COLUMBIA RAILWAY COMPANY CONSOLIDATED INCOME AND DEFICIT

	(Dollars in Thousands)	
	Fiscal Year Ended	
	December 31 1984	December 30 1983
Revenues	<u>\$256,108</u>	<u>\$205,446</u>
Expenses		
Operations	57,028	52,432
Equipment	58,099	56,468
Road	33,693	29,372
Depreciation	26,520	18,312
Other	19,076	16,682
Government assistance — Note 9	(5,217)	(7,772)
	<u>189,199</u>	<u>165,494</u>
Railway operating income	<u>66,909</u>	<u>39,952</u>
Non-operating income (expense)		
Interest — Note 10	(46,990)	(48,633)
Debt servicing assistance — Note 10	22,475	46,367
	<u>(24,515)</u>	<u>(2,266)</u>
Other income	1,636	2,281
	<u>(22,879)</u>	<u>15</u>
Net income before deferred income taxes	<u>44,030</u>	<u>39,967</u>
Provision for deferred income taxes — Note 11	1,343	—
Net income before minority interest	<u>42,687</u>	<u>39,967</u>
Minority interest	8,345	—
Net income	<u>34,342</u>	<u>39,967</u>
Deficit, beginning of period	274,139	314,106
Share issue costs less deferred income taxes of \$3,297	3,044	—
	<u>242,841</u>	<u>274,139</u>
Transfer to contributed surplus — Note 12	242,841	—
Deficit, end of period	<u>\$ —</u>	<u>\$274,139</u>

BRITISH COLUMBIA RAILWAY COMPANY

CONSOLIDATED CHANGES IN FINANCIAL POSITION

	(Dollars in Thousands)	
	Fiscal Year Ended	
	December 31 1984	December 30 1983
SOURCE OF CASH		
Operations		
Net income	\$34,342	\$39,967
Depreciation	26,520	18,312
Interest expense	46,990	48,633
Deferred income taxes	1,343	—
Government operating assistance	(5,217)	(7,772)
Government debt servicing assistance	(22,475)	(46,367)
	<u>81,503</u>	<u>52,773</u>
Decrease in non-cash working capital deficiency	<u>(40,968)</u>	<u>(4,068)</u>
	<u>40,535</u>	<u>48,705</u>
Government assistance		
Purchase of sinking funds — Note 4	429,989	—
Debt servicing — Note 10	29,358	70,000
Other — Note 9	7,287	15,571
	<u>466,634</u>	<u>85,571</u>
Other		
Shares	—	27,115
Minority interest	290,000	—
Gain on defeasance of debt — Note 4	179,200	—
Long-term debt	—	180,955
	<u>379,200</u>	<u>208,070</u>
	<u>886,369</u>	<u>342,346</u>
USE OF CASH		
Financing activities		
Debt retirement	779,343	20,291
Interest expense	46,990	48,633
Share issue costs	6,341	—
	<u>832,674</u>	<u>68,924</u>
Invested in future operations		
Property and equipment	66,379	262,644
Deferred operating assistance	250	—
	<u>66,629</u>	<u>262,644</u>
	<u>899,303</u>	<u>331,568</u>
INCREASE (DECREASE) IN CASH	<u>(12,934)</u>	<u>10,778</u>
Cash, beginning of period	<u>22,583</u>	<u>11,805</u>
Cash, end of period	<u>\$ 9,649</u>	<u>\$22,583</u>

BRITISH COLUMBIA RAILWAY COMPANY

CONSOLIDATED CONTRIBUTED SURPLUS

	<i>(Dollars in Thousands)</i>	
	Fiscal Year Ended	
	December 31 1984	December 30 1983
Balance, beginning of period	\$137,485	\$113,852
Debt servicing assistance — Note 10	6,883	23,633
Refinancing grant — Note 4	429,989	—
Gain on defeasance of debt — Note 4	179,200	—
Transferred from deficit — Note 12	(242,841)	—
Balance, end of period	<u>\$510,716</u>	<u>\$137,485</u>

BRITISH COLUMBIA RAILWAY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1984

1. Significant Accounting Policies

The accounting regulations prescribed by the Canadian Transport Commission for Canadian railways have been adopted to the extent that this is possible without submitting specific accounting policies and depreciation rates to the Commission for approval.

Basis of consolidation

The consolidated financial statements include the accounts of the company and its subsidiaries BCR Properties Ltd. and BC Rail Ltd. All significant inter-company transactions are eliminated.

Class of business

The company provides a fully integrated rail freight service within British Columbia. Services other than hauling freight are not of sufficient size to warrant separate reporting.

Road property

New construction is recorded at cost net of Government grants received. Abandoned or relocated sections are removed at average unit costs. Elements of track structure installed during planned programs are recorded at cost and the material replaced is removed at amounts which approximate average unit costs. Labour costs for programmed replacements are expensed as incurred.

All costs of constructing rail lines are capitalized to the date the line is certified operational by the British Columbia Ministry of Transportation and Highways. Capitalization of interest ceases and provision of depreciation commences on the date of certification.

Depreciation

Depreciation is provided for major categories of property and equipment on the straight-line basis at composite rates estimated to reduce the original cost to estimated salvage value over the average service lives of the classes. The group method is used for recording depreciation under which, on disposal, the original cost of assets retired less salvage value is charged against accumulated depreciation. No gain or loss on retirements, other than on accidental destruction of rolling stock and on disposal of land, is included in income. The original cost of assets less estimated salvage value is depreciated over the following number of years:

	Number of Years
Grades, surfacing and tunnels	100
Rails	50
Ties	20
Ballast	25
Bridges	30-80
Locomotives and power units	25
Freight cars	33

Repairs

Repairs and non-programmed replacements of track structure are charged against current operations. Betterments and major track relocations are capitalized.

Materials and supplies

Inventories of materials and supplies are valued at the lower of average cost and net realizable value.

Government assistance

Grants directly related to the construction or rehabilitation of road property have offset related road property capital expenditures. Operating assistance has been deducted from the related expense accounts. Assistance provided by the Province of British Columbia ("Province") in its capacity as shareholder has been credited to contributed surplus.

Income taxes

Income tax expense is computed on the basis of accounting income recorded by the railway operating subsidiary. No taxes are currently payable as the subsidiary intends to claim certain amounts for income tax purposes in excess of those recorded in the accounts and additionally will deduct share issue costs for tax purposes. The future benefit of the recorded accounting loss after deducting share issue costs has been included in the accounts as deferred income taxes. The company and BCR Properties Ltd. are exempt from Canadian federal and provincial income taxes.

Transactions in foreign currency

Transactions originating in United States currency are translated at the approximate exchange rates prevailing at the dates of the transactions. Assets and liabilities denominated in foreign currency at the balance sheet date are translated to equivalent Canadian amounts at the current rate of exchange.

NOTES

Leases

Certain long-term lease transactions relating to the financing of equipment are accounted for as purchases. The capital lease obligations reflect the present value of future minimum rental payments discounted at the interest rate implicit in the leases. The capitalized values of depreciable assets are generally depreciated over the related lease terms in equal annual amounts. Costs of all other leases are charged against operations as incurred.

Fiscal year

In 1984, the fiscal year of the company was changed to end on December 31.

2. Corporate Re-organization

On June 19, 1984, the company sold all its railway assets and undertaking except industrial parks and certain undeveloped land to BC Rail Ltd. On the same day, the company sold its undeveloped land and industrial parks to BCR Properties Ltd.

3. Dease Lake Extension

These costs consist of charges relating to the uncompleted Dease Lake extension. Construction was suspended in 1977 and there are no commitments to continue. In the event any portion of this extension is abandoned, the cost less any value recovered will be written off at that time.

4. Long-Term Debt

On June 15, 1984, the Province paid to the company \$429,989,000 which was placed in sinking funds and, together with amounts then in the sinking funds, was used to acquire securities issued or guaranteed by the Province. These securities will provide sufficient funds to service and retire obligations issued by the company which had a recorded book value including interest on June 15, 1984, of \$609,189,000. Both the amount received and the difference of \$179,200,000 between the recorded value of the debt and the amount provided by the Province were credited to contributed surplus.

Long-term debt outstanding, less current maturities, consists of the following:

	1984	1983
Sinking fund bonds and debentures		
1984-1988 — 3.25% to 4.75%		\$ 34,204,000
1989-1993 — 5.75% to 7.66%		67,479,000
1994-1998 — 4.5% to 9.34%		247,052,000
1999-2003 — 9.05% to 10.5%		338,218,000
2004-2005 — 12.75%		45,000,000
		<u>751,953,000</u>
Less sinking fund assets net of company's own bonds held		<u>144,823,000</u>
		587,130,000
Notes and bonds		
16.875% — due 1986 and 1996		18,701,000
Serial bonds		
4.875% — due 1988		<u>1,138,000</u>
		606,969,000
Capital lease obligations — Note 7	<u>\$44,320,000</u>	<u>37,123,000</u>
	44,320,000	644,092,000
Deduct current portion	<u>993,000</u>	<u>9,754,000</u>
	43,327,000	634,338,000
Notes payable		
To the Province	<u>152,955,000</u>	<u>—</u>
Other	<u>—</u>	<u>341,287,000</u>
	<u>\$196,282,000</u>	<u>\$975,625,000</u>

The notes payable to the Province are arranged under a borrowing agreement between the company and the Province. The present notes outstanding bear interest at rates between 10.0% and 12.5%.

5. Minority Interest

The minority interest consists of 8,000,000 series 1-A first preferred shares with a par value of \$25.00 each issued by BC Rail Ltd. These shares are designated as \$2.3125 cumulative, redeemable and retractable.

6. Share Capital

Authorized

10,000,000 shares with a par value of \$100 each.

Issued

2,576,885 shares are outstanding and held by the Province.

As all of the shares are held by the Province earnings per share has not been provided.

7. Commitments

The company has significant lease commitments for rolling stock and additional minor lease commitments for equipment and real estate which expire at various dates prior to the year 2000. Certain of these leases transfer substantially all of the benefits and risks of ownership to the company and are accounted for as capital assets.

The following is a schedule of future minimum rental payments at December 31, 1984, required under non-cancellable leases that have terms in excess of one year:

	Capital leases	Operating leases
1985	\$ 6,569,000	\$ 13,837,000
1986	6,569,000	13,533,000
1987	6,569,000	13,060,000
1988	6,569,000	12,875,000
1989	6,569,000	11,926,000
Later years	68,387,000	45,275,000
Total minimum lease payments	101,232,000	\$ 110,506,000
Less		
Executory costs	3,984,000	
Imputed interest	52,928,000	
Present value	\$44,320,000	

Assets under capital leases recorded in the property and equipment accounts as at December 31, 1984 are as follows:

Equipment	\$46,514,000
Accumulated depreciation	6,137,000
	<u>\$40,377,000</u>

8. Contingent Liabilities

The company is contingently liable with respect to pending litigation and claims which arose in connection with construction of the Tumbler Ridge rail line and in the normal course of business. In the opinion of management any liability that may arise will be capitalized or would not have a material adverse effect on future income.

9. Government Assistance

Government assistance received was as follows:

	1984	1983
Debt related		
From the Province		
Defeasance —		
Note 4	\$429,989,000	\$ —
Servicing —		
Note 10	29,358,000	70,000,000
	<u>\$459,347,000</u>	<u>\$70,000,000</u>

Other

From the Province

Fort Nelson extension		
Operating Rehabilitation	\$2,867,000	\$ 5,359,000
Tumbler Ridge rail line electrification	145,000	393,000
Takla extension	—	2,500,000
Passenger operation	—	375,000
Passenger car modernization	2,100,000	2,038,000
	500,000	—

From the Government of Canada

Tumbler Ridge rail line electrification	1,675,000	4,906,000
	<u>\$ 7,287,000</u>	<u>\$15,571,000</u>

The following were treated as a reduction of operating expenses

Fort Nelson extension	\$ 2,867,000	\$ 5,359,000
Takla extension	—	375,000
Passenger operation	2,100,000	2,038,000
Passenger car modernization	250,000	—
	<u>\$ 5,217,000</u>	<u>\$ 7,772,000</u>

The balance of the other assistance, except for \$250,000 which will be credited to operations in a future period, has been applied to reduce amounts included in property and equipment.

NOTES

10. Interest Expense

The Province granted \$29,358,000 to assist in paying the 1984 debt servicing charges of the company to June 15, 1984 (Note 9). Of this amount, \$22,475,000 was applied to offset interest on long-term debt and the balance of \$6,883,000 is included in contributed surplus.

Interest expense is as follows:

	<u>1984</u>	<u>1983</u>
Interest on long-term debt and notes		
Province	\$ 3,663,000	\$ —
Other	53,848,000	91,944,000
	<u>57,511,000</u>	<u>91,944,000</u>
Less		
Sinking fund earnings	5,965,000	13,150,000
Interest capitalized	6,859,000	30,232,000
Interest earned on temporary investments	2,680,000	2,195,000
	<u>15,504,000</u>	<u>45,577,000</u>
	<u>42,007,000</u>	<u>46,367,000</u>
Interest on capital lease obligations	4,983,000	2,266,000
	<u>46,990,000</u>	<u>48,633,000</u>
Less		
Application of debt servicing assistance	22,475,000	46,367,000
Net interest	<u>\$24,515,000</u>	<u>\$ 2,266,000</u>

11. Income Taxes

The effective tax rate of 3% differs from the rate of 52% applicable to British Columbia companies because the net income of the company and BCR Properties Ltd. is exempt from federal and provincial income taxes.

12. Contributed Surplus

The Province instructed the company to consolidate its accumulated deficit with contributed surplus as at December 31, 1984.

13. Pension Plan

The majority of the company's employees participate in a contributory pension plan and are entitled to limited vested rights prior to retirement. An actuarial valuation as at May 31, 1984 disclosed that the plan was fully funded.

The total pension expense for the current period was \$5,486,000; (1983 - \$6,450,000).

14. Related Party Transactions

Related party information not included elsewhere in the notes to financial statements is presented below.

The first preferred shares of a subsidiary and certain capital lease obligations are guaranteed by the Province. The Ministry of Finance of the Province acts as fiscal agent in the administration of the debt and the Superannuation Commission of the Province administers the company pension plan. Fees are charged for both of these services.

The company received assistance from the Province during the year and is exempted from all taxes levied by the Province. All other transactions between the company and the Province are at terms no more or less favourable than those with unrelated parties.

FIVE YEAR REVIEW

(Dollars in Thousands)

FISCAL YEAR

CONSOLIDATED STATEMENT OF INCOME

	<u>1984</u>	<u>1983</u>	<u>1982</u>	<u>1981</u>	<u>1980</u>
Revenues	<u>\$256,108</u>	<u>\$205,446</u>	<u>\$159,696</u>	<u>\$152,539</u>	<u>\$143,726</u>
Expenses					
Operations	57,028	52,432	46,883	47,266	46,510
Equipment	58,099	56,468	45,281	46,146	43,567
Road	33,693	29,372	25,759	28,582	28,920
Depreciation	26,520	18,312	17,436	17,125	14,279
Other	19,076	16,682	15,183	14,176	9,462
Government assistance	(5,217)	(7,772)	(8,725)	(3,812)	(6,510)
	<u>189,199</u>	<u>165,494</u>	<u>141,817</u>	<u>149,483</u>	<u>136,228</u>
 Railway operating income	 66,909	 39,952	 17,879	 3,056	 7,498
 Non-operating income (expense)					
Interest	(46,990)	(48,633)	(52,303)	(54,800)	(58,472)
Debt servicing assistance	22,475	46,367	49,985	52,591	57,522
	(24,515)	(2,266)	(2,318)	(2,209)	(950)
Other income	1,636	2,281	3,023	2,318	6,094
	(22,879)	15	705	109	5,144
 Net income before deferred income taxes	 44,030	 39,967	 18,584	 3,165	 12,642
Provision for deferred income taxes	1,343	—	—	—	—
 Net income before minority interest	 42,687	 39,967	 18,584	 3,165	 12,642
Minority interest	8,345	—	—	—	—
 Net income	 <u>\$ 34,342</u>	 <u>\$ 39,967</u>	 <u>\$ 18,584</u>	 <u>\$ 3,165</u>	 <u>\$ 12,642</u>

OPERATING STATISTICS

Total revenue cars loaded on line	197,643	145,571	126,031	131,624	143,609
Received from connections	2,614	3,198	2,546	3,358	4,634
Total carloadings	<u>200,257</u>	<u>148,769</u>	<u>128,577</u>	<u>134,982</u>	<u>148,243</u>

MOTIVE POWER

Electric locomotives	7	7	—	—	—
Diesel locomotives	115	123	126	126	126

ROLLING STOCK FLEET

Freight cars	10,060	9,690	9,811	9,855	9,966
Passenger cars	9	9	6	6	7
Boarding and work cars	469	446	493	504	509

TONS HAULED

14,672,412	9,347,107	8,023,581	8,323,124	8,663,746
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EMPLOYEES AT YEAR END

2,640	2,600	2,400	2,500	2,800
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FINANCIAL STATEMENTS FOR BC RAIL LTD.

The head-end of a 98-car unit coal train
nearing Tumbler Ridge, B.C., the
newly-built town serving the mines of
northeastern British Columbia. The
Bullmoose and Quilstat mines each
have load-out facilities nearby.

BC RAIL LTD. MANAGEMENT REPORT

The financial statements of BC Rail Ltd. have been prepared by management in accordance with accounting principles generally accepted in Canada for railways. Management is responsible for the accuracy, integrity and objectivity of the information contained in the financial statements and to ensure that the presentation conforms with generally accepted accounting principles.

The independent auditors, Peat, Marwick, Mitchell & Co., have been appointed by the Shareholders to express an opinion as to whether these financial statements present fairly the company's financial position and operating results in conformity with generally accepted accounting principles. Their report

outlines the scope of their examination and gives their opinion on the fairness of the statement presentation.

The Audit Committee of the railway directors appointed by the Board meets periodically with financial officers of the railway and the external auditors to ensure that each group is fulfilling its obligations and to review and approve the annual financial statements prior to their release.

Management maintains an extensive system of internal accounting controls and believes that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial statements. The adequacy and operation of the control systems are monitored on

an on-going basis by an internal audit department.

The Canadian Institute of Chartered Accountants recommends that supplementary information on the effects of changing prices be presented together with the annual financial statements of large publicly-held enterprises. Management does not believe that the development of this information is practicable.

The financial statements have, in the opinion of the management of the company, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized in Note 1 of the Notes to the financial statements.

AUDITORS' REPORT

To the Shareholders

We have examined the balance sheet of BC Rail Ltd. as at December 31, 1984 and the statements of income and deficit, contributed surplus and changes in financial position for the nine months then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company

as at December 31, 1984 and the results of its operations and the changes in its financial position for the nine months then ended in accordance with generally accepted accounting principles.

Peat, Marwick, Mitchell & Co.

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Vancouver, British Columbia,
Canada
February 28, 1985

BC RAIL LTD. BALANCE SHEET

December 31, 1984

(Dollars in Thousands)

Assets

Current assets

Cash	\$ 9,643
Accounts receivable	39,604
Materials and other items	31,778
Due from British Columbia Railway Company	10,885
	<u>91,910</u>

Deferred income taxes	1,954
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Property and equipment — Note 2

Road and buildings	1,033,327
Equipment	229,476
	<u>1,262,803</u>

Accumulated depreciation	195,668
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	<u>1,067,135</u>
Dease Lake extension — Note 3	98,020
	<u>\$1,259,019</u>

Liabilities and Shareholders' Equity

Current liabilities

Accounts payable	\$ 85,740
Current obligations on long-term debt	993
Due to BCR Properties Ltd.	29,961
	<u>116,694</u>

Long-term debt — Note 4	598,782
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Shareholders' equity

Share capital — Note 5	411,690
Contributed surplus	133,655
	<u>545,345</u>

Deficit	1,802
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	<u>543,543</u>
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Contingent liabilities — Note 6

Commitments — Note 7

\$1,259,019

On behalf of the Board

S. M. Horner *M. C. Norris*

S. M. Horner, Director

M. C. Norris, Director

BC RAIL LTD. INCOME AND DEFICIT

For the Nine Months Ended December 31, 1984 — Note 2

	<i>(Dollars in Thousands)</i>
Revenues	<u>\$149,732</u>
Expenses	
Operations	31,685
Equipment	31,619
Road	19,098
Depreciation	14,923
Other	10,751
Government assistance — Note 8	<u>(2,153)</u>
	<u>105,923</u>
Railway operating income	43,809
Non-operating income (expense)	
Interest — Note 9	(41,479)
Other income	<u>255</u>
Net income before deferred income taxes	2,585
Provision for deferred income taxes	<u>1,343</u>
Net income	1,242
Share issue costs less deferred income taxes of \$3,297	<u>3,044</u>
Deficit, end of period	<u><u>\$ 1,802</u></u>

CONTRIBUTED SURPLUS

For the Nine Months Ended December 31, 1984 — Note 2

		<i>(Dollars in Thousands)</i>
Common shares — Note 5		\$150,000
Dividends paid		
Preferred shares	\$8,345	
Common shares	<u>8,000</u>	<u>16,345</u>
Balance, end of period		<u><u>\$133,655</u></u>

BC RAIL LTD.

CHANGES IN FINANCIAL POSITION

For the Nine Months Ended December 31, 1984 — Note 2

(Dollars in Thousands)

SOURCE OF CASH

Operations

Net income	\$ 1,242
Interest expense	41,479
Depreciation	14,923
Deferred income taxes	1,343
Government operating assistance	(2,153)
	<u>56,834</u>

Decrease in non-cash working capital	34,427
	<u>91,261</u>

Government assistance

Operating	2,403
Capital	75
	<u>2,478</u>

Other

Note issue	702,955
Shares	411,690
Contributed surplus	150,000
Long-term debt	43,989
	<u>1,308,634</u>
	<u>1,402,373</u>

USE OF CASH

Financing activities

Debt retirement	148,162
Interest expense	41,479
Dividends	16,345
Share issue costs	6,341
	<u>212,327</u>

Invested in future operations

Property and equipment	1,180,153
Deferred operating assistance	250
	<u>1,180,403</u>
	<u>1,392,730</u>

Cash, end of period	<u><u>\$ 9,643</u></u>
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BC RAIL LTD. NOTES TO FINANCIAL STATEMENTS

December 31, 1984

1. Significant Accounting Policies

The accounting regulations prescribed by the Canadian Transport Commission for Canadian railways have been adopted to the extent that this is possible without submitting specific accounting policies and depreciation rates to the Commission for approval.

Class of business

The company provides a fully integrated rail freight service within British Columbia. Services other than hauling freight are not of sufficient size to warrant separate reporting.

Road property

New construction is recorded at cost net of Government grants received. Abandoned or relocated sections are removed at average unit costs. Elements of track structure installed during planned programs are recorded at cost and the material replaced is removed at amounts which approximate average unit costs. Labour costs for programmed replacements are expensed as incurred.

All costs of constructing rail lines are capitalized to the date the line is certified operational by the British Columbia Ministry of Transportation and Highways. Capitalization of interest ceases and provision of depreciation commences on the date of certification.

Depreciation

Depreciation is provided for major categories of property and equipment on the straight-line basis at composite rates estimated to reduce the original cost to estimated salvage value over the average service lives of the classes. The group method is used for recording depreciation under which, on disposal, the original cost of assets retired less salvage value is charged against accumulated depreciation. No gain or loss on retirements, other than on accidental destruction of rolling stock and on disposal of land, is included in income. The original cost of assets less estimated salvage value is depreciated over the following number of years:

	Number of Years
Grades, surfacing and tunnels	100
Rails	50
Ties	20
Ballast	25
Bridges	30-80
Locomotives and power units	25
Freight cars	33

Repairs

Repairs and non-programmed replacements of track structure are charged against current operations. Betterments and major track relocations are capitalized.

Materials and supplies

Inventories of materials and supplies are valued at the lower of average cost and net realizable value.

Government assistance

Grants directly related to the construction or rehabilitation of road property have offset related road property capital expenditures. Operating assistance has been deducted from the related expense accounts.

Income taxes

Income tax expense is computed on the basis of accounting income recorded by the company. No taxes are currently payable as the company intends to claim certain amounts for income tax purposes in excess of those recorded in the accounts and additionally will deduct share issue costs for tax purposes. The future benefit of the recorded accounting loss after deducting share issue costs has been included in the accounts as deferred income taxes.

Transactions in foreign currency

Transactions originating in United States currency are translated at the approximate exchange rates prevailing at the dates of the transactions. Assets and liabilities denominated in foreign currency at the balance sheet date are translated to equivalent Canadian amounts at the current rate of exchange.

Leases

Certain long-term lease transactions relating to the financing of equipment are accounted for as purchases. The capital lease obligations reflect the present value of future minimum rental payments discounted at the interest rate implicit in the leases. The capitalized values of depreciable assets are generally depreciated over the related lease terms in equal annual amounts. Costs of all other leases are charged against operations as incurred.

Fiscal year

In 1984, the fiscal year of the company was changed from March 31 to end on December 31.

2. Commencement of Railway Operations

The company purchased from British Columbia Railway Company effective June 19, 1984 all of that company's railway assets and undertaking, except industrial parks and certain undeveloped land. The purchase price of the property and equipment was \$1,148,586,000, equal to the net book value in the accounts of the vendor, and represents the fair market value of the assets. These assets have been included in the accounts of the company at the original cost less accumulated depreciation of \$183,291,000 recorded in the vendor's accounts at the date of sale. Depreciation provided prior to acquisition of the property and equipment by the company was at the rates and on the basis used by the company. Subsequent additions have been recorded at cost.

The company's operations prior to June 19, 1984 were discontinued. As they were not material in relation to the railway operation comparative information has not been provided.

3. Dease Lake Extension

Included in the assets acquired from British Columbia Railway Company were costs related to the uncompleted Dease Lake extension. Construction was suspended in 1977 and there are no commitments to continue. In the event any portion of this extension is abandoned, the cost less any value recovered will be written off at that time.

4. Long-term Debt

Long-term debt outstanding, less current maturities, consists of the following:

Capital lease obligations —	
Note 6	\$44,320,000
Deduct current portion	<u>993,000</u>
	43,327,000
 Note payable to BCR Properties Ltd.	
— 14%, due June 19, 1999	402,500,000
Notes payable to the Province	<u>152,955,000</u>
	<u>\$598,782,000</u>

The notes payable to the Province are arranged under a borrowing agreement between the company and the Province. The present notes outstanding bear interest at rates between 10.0% and 12.5%.

5. Share Capital

Authorized

5,000,000 common shares with a par value of \$100 each

20,000,000 first preferred shares with a par value of \$25 each of which 8,000,000 are designated as \$2.3125 cumulative redeemable retractable first preferred shares, series A

20,000,000 second preferred shares with a par value of \$100 each of which 3,000,000 have been designated as non-cumulative redeemable second preferred shares, series A

Issued and outstanding

500,012 common shares including 500,000 which were issued during the period for property and equipment having a value of \$200,000,000, \$150,000,000 of which was allocated to contributed surplus

\$ 50,001,000

8,000,000 series 1-A preferred shares issued for cash during the period

200,000,000

1,616,892 series 2-A preferred shares issued during the period at par value for property and equipment

161,689,000

\$411,690,000

6. Contingent Liabilities

The company is contingently liable with respect to pending litigation and claims which arose in connection with construction of the Tumbler Ridge rail line and in the normal course of business. In the opinion of management any liability that may arise will be capitalized or would not have a material adverse effect on future income.

7. Commitments

The company assumed significant lease commitments for rolling stock and additional minor lease commitments for equipment and real estate which expire at various dates prior to the year 2000. Certain of these leases transfer substantially all of the benefits and risks of ownership to the company and are accounted for as capital assets.

The following is a schedule of future minimum rental payments at December 31, 1984, required under non-cancellable leases that have terms in excess of one year:

NOTES

Capital leases Operating leases

1985	\$ 6,569,000	\$ 13,837,000
1986	6,569,000	13,533,000
1987	6,569,000	13,060,000
1988	6,569,000	12,875,000
1989	6,569,000	11,926,000
Later years	68,387,000	45,275,000
Total minimum lease payments	101,232,000	<u>\$110,506,000</u>

Less	
Executory costs	3,984,000
Imputed interest	<u>52,928,000</u>
Present value	<u>\$44,320,000</u>

Assets under capital leases recorded in the property and equipment accounts as at December 31, 1984 are as follows:

Equipment	\$46,514,000
Accumulated depreciation	<u>6,137,000</u>
	<u>\$40,377,000</u>

8. Government Assistance

Government assistance received subsequent to June 19, 1984 was as follows:

From the Province	
Fort Nelson extension	
Operating	\$ 860,000
Rehabilitation	75,000
Passenger operation	1,115,000
Passenger car modernization	428,000
	<u>\$ 2,478,000</u>

Of the above, the following were treated as a reduction in operating expenses:

Fort Nelson extension	\$ 860,000
Passenger operation	1,115,000
Passenger car modernization	178,000
	<u>\$ 2,153,000</u>

9. Interest Expense

Interest expense is as follows:

Notes payable — 14%	
BCR Properties Ltd.	\$31,011,000
British Columbia	
Railway Company	<u>10,337,000</u>
	41,348,000
Short-term notes payable to the Province	<u>3,663,000</u>
Capital lease obligations	<u>2,752,000</u>
	<u>47,763,000</u>
Less interest income	
Related companies	4,978,000
Other	<u>1,306,000</u>
	6,284,000
	<u>\$41,479,000</u>

10. Pension Plan

The majority of the company's employees participate in a contributory pension plan and are entitled to limited vested rights prior to retirement. An actuarial valuation as at May 31, 1984 disclosed that the plan was fully funded.

The total pension expense since June 19, 1984 was \$2,509,000.

11. Related Party Transactions

Related party information not presented elsewhere in the notes to financial statements is presented below.

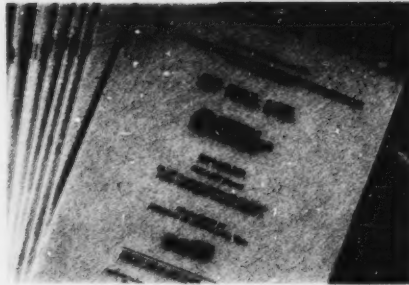
All of the outstanding common and second preferred shares of the company are owned as follows:

BCR Properties Ltd., (a wholly-owned subsidiary of British Columbia Railway Company)	75%
British Columbia Railway Company	25%

First preferred shares and certain capital lease obligations are guaranteed by the Province. The Ministry of Finance of the Province acts as fiscal agent in the administration of the debt and the Superannuation Commission of the Province administers the company pension plan. Fees are charged for both of these services.

The company received assistance from the Province during the year and is exempted from all taxes, with the exception of income taxes, levied by the Province. All other transactions between the company and its shareholders are at terms no more or less favourable than those with unrelated parties.

THE RAILWAY RESTRUCTURED



On June 19th, 1984, BC Rail Ltd., a taxable Canadian corporation, became the railway operating subsidiary of the British Columbia Railway Company and BCR Properties Ltd. BCR Properties, which owns and manages the non-operating real estate assets of the group, holds 75 per cent of the common shares of BC Rail. The remaining 25 per cent of the common shares are held by the British Columbia Railway Company, which is wholly-owned by the Province of British Columbia as a Crown corporation.

Concurrent with the reorganization, BC Rail Ltd. offered eight million Series 'A' First Preferred Shares, at a unit price of \$25, for sale on Canadian stock exchanges. The non-voting shares are guaranteed to yield 9.25 per cent by the Government of British Columbia. They are cumulative, redeemable and retractable and yield \$2.3125 per share per year. A pro-rated dividend of \$0.46501 per share was paid to preferred shareholders on September 1st, 1984. A quarterly dividend of \$0.578125 per share was paid on December 1st, 1984.

Completion of the offering was concurrent with completion of a Railway Purchase Agreement, under which BC Rail Ltd. purchased the railway assets and undertaking of British Columbia Railway Company. The price paid

by BC Rail was the net book value of the fixed assets, \$1.1 billion, plus the book value of current assets at the close of business on June 18th, 1984. The price was satisfied by the assumption of certain liabilities, the payment of \$200 million realized from the first preferred share offering, the issue of 500,000 common shares, the issue of \$550 million of notes and the balance by the issue of Non-Cumulative, Redeemable Second Preferred Shares of BC Rail.

The reorganization followed a provincial government decision to extinguish the historic debt of the railway by a payment of \$430 million to the company. That sum, added to \$146 million held in sinking funds, was used to effectively retire the historic debt incurred through the construction of uneconomic lines in the interests of provincial development.

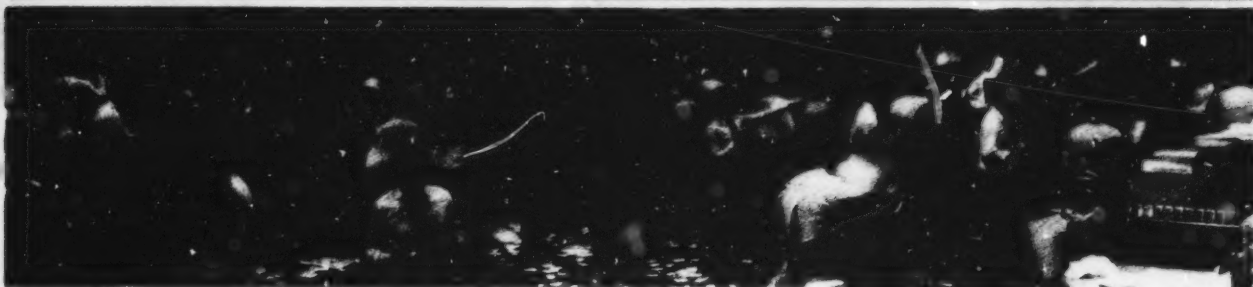
Concurrent with this payment, the railway assumed full responsibility for the construction of the Tumbler subdivision. Debt assistance grants from the provincial government amounting to approximately \$70 million per annum — intended to assist in servicing the historic debt — ceased. At the same time, coal transportation surcharges, which originally were to have been paid by mining companies to the provincial government, were

assigned to the railway.

The effective retirement of the historic debt left the railway with debt amounting to approximately \$366 million, financed by short-term notes at interest rates then approximating 11 per cent. As the Tumbler Ridge line became operational and coal traffic gained momentum, longer term financing was appropriate. After applying the proceeds of the first preferred share offering, BC Rail's remaining external debt at the end of 1984 stood at \$196.3 million. The railway services this debt and covers dividend obligations on the preferred share issue from its operating revenues and resources.

Prior to the offering, long-term capital was available to the railway through the sale of bonds or debentures at interest rates approximating 14 per cent. At a guaranteed dividend of 9.25 per cent, the issuance of first preferred shares offered an attractive, alternative means of financing.

The issue also proved attractive to the Canadian investment community. It was offered through a syndicate of Canadian investment dealers. Presentations were made to investment dealers in Vancouver, Toronto and Montreal, all of which were successful and resulted in prompt, full subscription of the offering.



Thus, the British Columbia Railway group was formed. Incorporated by provincial statute in 1912 as Pacific Great Eastern Railway, the railway changed its name in 1972 to British Columbia Railway Company. Since that time, the railway has undertaken an intensive program of modernization and renewal, highlighted by the opening of the electrified Tumbler subdivision in northeastern B.C.

Management and direction of the group remained unchanged as a result of the financial reorganization. The management committee and board of directors of British Columbia Railway Company continue to serve in the same capacities for both BC Rail Ltd. and BCR Properties Ltd.

BC Rail retains a right of redemption of the Series 'A' First Preferred Shares, under which it may require shareholders to sell to BC Rail all or any of their shares at any time on or after June 1st, 1987, at a premium over the issued price. The redemption price ranges from \$26.67 on that date, declining

to \$25.33 if redeemed during the 12-month period beginning June 1st, 1991 and thereafter, at a price of \$25 plus accrued and unpaid dividends.

Similarly, shareholders have a right of retraction, which allows them to require BC Rail Ltd. to purchase their preferred shares on June 1st, 1989, at \$25 per share plus accrued and unpaid dividends.

At the time of the offering, BC Rail declared its intention to make all reasonable efforts in each quarter beginning January 1st, 1986, to purchase for cancellation in the open market three quarters of one per cent of the Series 'A' First Preferred Shares at a price not exceeding \$25 per share plus transaction costs.

Authorized capital of BC Rail consists of 20 million first preferred shares, with a par value of \$25 each; 20 million second preferred shares with a par value of \$100 each and five million common shares with a par value of \$100 each.

The 1984 fiscal year was the

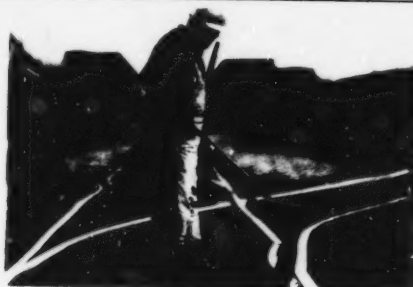
British Columbia Railway Company's third year of record net income before minority interest. The effect of the financial reorganization was to place the operating railway on a firm financial footing, in keeping with its role as a commercially-driven and profit-motivated transportation company. The railway approaches the latter half of the decade with confidence, alert to the possibility of further development provided such development is economically sound. In the near future, the railway will be considering strategies for obtaining additional revenues from its Communications and Real Estate Development departments, as well as from a joint consulting services venture with Swan Wooster Engineering Ltd.

Under its new financial structure, the railway's value as a provincial asset has improved. For its owners and employees, the future promises to be exciting and rewarding.

BC Rail's first 6,000 hp electric locomotive is groomed after her long delivery journey from London, Ontario. Like the six counterparts that followed soon after, 6001 made the 3,000-mile (5,000 km) journey as part of the consist of a CP Rail transcontinental freight.

In May 1984, the company made its first public share offering in the form of guaranteed, redeemable and retractable preferred shares. The offering, traded on principal Canadian stock exchanges, was fully subscribed in less than 48 hours.

CONTACT INFORMATION



*If you would like to know more
about the British Columbia
Railway group of companies,
contact:*

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BC Rail's mainline winds through some of the most spectacular scenery in the world. This northbound freight is beginning a long haul that will terminate 979 miles (1566 km) later in Fort Nelson, B.C., near the province's boundary with the Yukon and North West Territories.

The company's workforce is stable and contains a high percentage of long-serving employees.